

DOCKET FILE COPY ORIGINAL
Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)	
)	CC Docket No. 97-158
Southwestern Bell Telephone Company)	Transmittal No. 2633
Tariff F.C.C. No. 73)	

PETITION FOR RECONSIDERATION OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Pursuant to Section 1.106 of the rules of the Federal Communications Commission (Commission), Southwestern Bell Telephone Company (SWBT), hereby respectfully requests that the Commission reconsider and reverse its recent order rejecting SWBT's Transmittal No. 2633.¹

Reconsideration of the RFP Tariff Rejection Order is also pursuant to 47 U.S.C. Section 405(b)(1) which requires that within 90 days of the filing of this petition, "the Commission shall issue an order granting or denying such petition."

I. BACKGROUND

On February 27, 1995, SWBT filed its first RFP tariff. In Transmittal No. 2433, SWBT proposed to offer services to a customer, MCI Telecommunications, which had requested that SWBT present a proposal to MCI in light of the competition already present in the Topeka, Kansas, and St. Louis, Missouri areas. In November, 1995, the Commission rejected this

¹ Southwestern Bell Telephone Company Tariff F.C.C. No. 73 CC Docket No. 97-158, Transmittal No. 2633, Order concluding investigation and denying application for review (FCC 97-394) (released November 14, 1997) (RFP Tariff Rejection Order).

transmittal on the grounds that it was vague, violated the Commission's geographically averaged rate requirement and did not satisfy the first prong of the competitive necessity test.

The U. S. Court of Appeals for the D.C. Circuit remanded the decision on SWBT's Transmittal No. 2433 back to the Commission on the grounds that the Commission had not properly stated a basis for its decision. As the Commission recognized in its Order, this remand remains pending after more than one year.

On May 5, 1997, SWBT filed Transmittal No. 2633, similar in nature to Transmittal No. 2433, in order to respond to requests for proposals (RFPs) received from AT&T Corp. (AT&T) and Coastal Telephone Company (Coastal). In the RFP Tariff Rejection Order, the Commission concluded that Transmittal No. 2633 would violate Section 202(a) of the Communications Act of 1934 and that the competitive necessity doctrine was inapplicable in the case of Transmittal No. 2633.

SWBT respectfully requests that the Commission reconsider the applicability of the competitive necessity doctrine to SWBT's RFP tariff offering. Commission precedent, as well as all of the expert economic evidence submitted in this proceeding, supports applicability of the doctrine and allowing SWBT's Transmittal No. 2633 to take effect.

II. APPLICABLE COMMISSION PRECEDENT SUPPORTS THE APPLICATION OF THE COMPETITIVE NECESSITY DOCTRINE TO SWBT'S TRANSMITTAL NO. 2633.

Contrary to the RFP Tariff Rejection Order, which ruled that Commission precedent does not require application of the competitive necessity doctrine to tariffs that are not

generally available,² applicable precedent supports use of the competitive necessity doctrine in this case. Under cases cited by the Commission, there is ample reason to use the competitive necessity doctrine to allow Transmittal No. 2633 to take effect.

In the Telpak proceedings cited in paragraph 33, the RFP Tariff Rejection Order indeed cites the fact that AT&T, a dominant carrier at that time, was allowed to use the competitive necessity doctrine to justify discounts on particular services. In claiming, however, that the Commission rejected the use of the doctrine³ in AT&T Revisions to Tariff FCC Nos. 260 and 267 concerning Resale and Shared Use, 64 F.C.C. 2d 1003 (1977), the Order misapplies this cited decision as the 1977 decision does not discuss the competitive necessity doctrine at all, let alone any assertion of the doctrine by AT&T in that portion of the proceedings. Thus, the Telpak proceedings are not contrary to SWBT's position.

The Order's discussion of the Private Line Guidelines Order also does not contradict SWBT's position.⁴ As the Order notes, those proceedings also allowed use of the competitive necessity doctrine to justify the challenged offerings. Likewise, the OCP Guidelines Order, as the Commission notes, did not foreclose use of the competitive necessity doctrine to carriers in the future.

The Order's discussion of the DS3 ICB Order also acknowledges that the competitive necessity doctrine is available to justify the reasonableness of potentially

² RFP Tariff Rejection Order at paras. 31-40.

³ Id. at para. 33.

⁴ Id. at para. 34.

discriminatory offerings of dominant carriers. As noted, the DS3 ICB Order merely stands for the proposition that the carriers had not introduced sufficient evidence of competition at that time to qualify under it.³

The Order's discussion of the AT&T CPP Order recognizes that the Commission initially rejected an AT&T offering that was too broadly offered. The Order acknowledges that the tariff in question was eventually allowed to take effect.

Especially noteworthy is the case of AT&T's Tariff 15. This tariff was a customer-specific offering, and was eventually allowed to take effect notwithstanding the Commission's initial objections to AT&T's use of the competitive necessity doctrine. The RFP Tariff Rejection Order does not cite any reason why the Commission's eventual action in allowing the tariff to take effect does not compel allowing SWBT's tariff to take effect here.

The Order also mentions the Commission's rejection of the prior SWBT RFP tariff. That proceeding is still on remand, and is of no precedential value.

Thus, none of the cases discussed by the order pose any bar to effectiveness of SWBT's filing, and the AT&T Tariff 15 case appears to even more directly support SWBT's arguments. This conclusion is bolstered by the Commission's tentative conclusions in the Decreased Regulation of Basic Telecommunications Services proceeding. While the Commission eventually closed the docket without taking any action, the Commission's tentative conclusion is an indication that the Commission's general attitude toward customer-specific offerings, at least in RFP cases (as far back as ten years ago), was to allow such offerings.

³Id. at para. 36.

Therefore, the precedent cannot be read together as prohibiting such tariffs, but instead should be examined in light of the Decreased Regulation of Basic Telecommunications Services proceeding's tentative conclusion to allow such tariffs to take effect. That tentative conclusion also makes the Commission's public interest finding, as discussed in the following section, all the more puzzling. The Commission apparently had no concern regarding the potential for possible foreclosure of competition when it tentatively concluded that dominant carriers should be allowed to participate in other RFP situations.⁶

III. THE OVERWHELMING WEIGHT OF THE EXPERT ECONOMIC EVIDENCE IN THIS PROCEEDING FAVORS APPLICATION OF THE COMPETITIVE NECESSITY DOCTRINE TO SWBT's TRANSMITTAL NO. 2633.

The article attached to the SWBT Direct Case⁷ and the affidavit attached to the comments of US West (Harris affidavit) filed in support of Transmittal No. 2633 are the vast majority of the total expert economic evidence filed in this matter. These documents, as well as the affidavit of Douglas Mudd attached hereto (Mudd affidavit), refute the Commission's conclusion that SWBT's Transmittal No. 2633 may foreclose competition and is not in the public interest.

As discussed in the Mudd affidavit, allowing SWBT to freely compete in the RFP processes used by customers will increase competition, not lessen it. The record cannot support

⁶The RFP Tariff Rejection Order's conclusions regarding the RFP process appear to be contrary to the Commission's Report and Order in CC Docket No. 96-45, where the Commission requires eligible health care providers and eligible schools and libraries to use competitive bidding to obtain tariffed services. Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order (FCC 97-157) (released May 8, 1997) at paras. 480, 686-89.

⁷Larson, Monson, & Nobles, Competitive Necessity and Pricing in Telecommunications Regulation, 42 FED. COMM. L. J. 1 (1989).

any other conclusion. SWBT's competitors are currently being protected from competition since SWBT is not allowed to price its services as freely as its competitors. Customers will benefit from the introduction of greater competition. There is no evidence in the record, only mere speculation, unsubstantiated by the sources cited by the order, that competitors will be foreclosed from entering markets if SWBT is allowed to price its services as requested.⁸

As SWBT's Transmittal No. 2633 will benefit customers due to the lower prices they will receive, and since there is no evidence that competitors will be foreclosed from entering markets due to SWBT's ability to price its services like its competitors, Transmittal No. 2633 is in the public interest. Application of the competitive necessity doctrine is therefore warranted.

IV. THE COMMISSION DOES NOT HAVE THE AUTHORITY TO PRECLUDE SWBT FROM SERVING ACCESS MARKETS

According to the Order, to enter the access market successfully, a new entrant must be able to attract a sufficient amount of business to achieve significant economies of scale.⁹ The Commission suggests that existing access providers will not have a reasonable expectation that their investments can be recovered without protection from the Commission. The Commission therefore concludes that it has the authority to shield these providers from competition until they can garner an unspecified market share. Not only is this conclusion based

⁸Paragraph 47 states that "the existence of only two RFP requests and their informal nature also adds credence to the opponents' view that the requests for competitive bids may have been only issued solely to gauge the extent of competition in the relevant markets." Given that SWBT lost the business in one of the cases, and was trying to win back business in the other, this statement of the RFP Tariff Rejection Order is unsupported and incorrect. Further, as noted by the Harris affidavit, this decision is contrary to the way in which AT&T was allowed to use contract pricing.

⁹ RFP Tariff Rejection Order at para. 49.

on erroneous assumptions that are dispelled by the attached Mudd affidavit, the Commission does not have the authority to grant such shelter at the expense of consumers.

First, access is not a cottage industry and the record in this proceeding does not support the Order's assumption that SWBT's competitors are tiny companies with limited resources. In contrast, companies like MCI, Worldcom, Teleport, AT&T and others are huge, publicly traded companies. Second, individual pricing in response to customer supplied RFPs is a common industry practice. MFS, for example, had over 1400 ICB offerings listed in a recent tariff.¹⁰ Most competitive access providers operate solely on an ICB basis. In practice, what the Commission has done by not allowing SWBT to engage in common industry practices (pricing in response to customer RFPs) is to preclude SWBT from competing in many access markets. The effect is confiscatory, violates SWBT's right to equal protection under the law, and thereby exceeds the Commission's authority.

¹⁰Paragraph 46 of the Order states that tariff pages from MFS and TCG only "purport" to demonstrate that these companies offer equal or lower-priced competitive alternatives. These were copies of actual tariff pages. If the actual tariffs themselves, however, do not offer credible proof of whether a company is offering service pursuant to it, an investigation of those tariffs may be warranted.

AFFIDAVIT OF DOUGLAS R. MUDD

I am employed as an economist, with an M.A. degree in economics from Southern Illinois University – Edwardsville, by Southwestern Bell Telephone Company. I have been responsible for reviewing, studying, and analyzing telecommunications policy decisions for eighteen years. The views expressed in this affidavit are based on my background in microeconomic theory, regulatory policy analysis, and my experience in the telecommunications industry.

In rejecting SWBT's Transmittal No. 2633, the Federal Communications Commission (FCC) declines "to apply the competitive necessity defense to Transmittal No. 2633, because of serious public interest concerns that SWBT could unreasonably employ this proposed tariff to forestall the development of competition by foreclosing or deterring market entry."¹ In particular, the Commission is concerned that SWBT will use a Request for Proposal (RFP) tariff to "preempt new market entrants in its territory by reducing rates to individual customers to which it believes new entrants may make offers."²

However, in practice, the RFP process will yield competitive pricing decisions similar to auction results, rather than a unilateral preemptive strategy intended to prevent competitors from bidding for any particular customer's business. Auctions, and hence

¹ Federal Communications Commission, Order Concluding Investigation and Denying Application for Review, CC Docket No. 97-158, Transmittal No. 2633, released November 14, 1997, (hereinafter RFP Tariff Rejection Order), at ¶ 15.

² Id. at ¶ 42.

RFPs, are typically treated as models of competitive markets in economics.³ Such models have demonstrated that auctions, and by extension RFPs, can achieve competitive prices with relatively few bidders (i.e., market participants).⁴ Concluding that the competitive necessity doctrine does not apply to SWBT's Transmittal 2633, the FCC effectively removes SWBT from the competitive RFP process, thereby reducing the number of alternatives available to customers requesting bids and perhaps preventing IXCs from acquiring inputs at economically efficient prices. This, in turn, could prevent consumers of retail telecommunications services from realizing the full benefits of competition since retail prices might not reflect minimum input costs. To move toward the generally accepted goals of fostering competition in telecommunications markets to achieve, among other things, an increased number of alternatives for customers and the lower prices expected from competition, the FCC should reconsider its decision that the competitive necessity doctrine does not apply to SWBT's Transmittal 2633.

As noted by the Commission and included in SWBT's filing, a letter from AT&T points out that because SWBT's tariff prices are "significantly higher than those of other access providers in the area, AT&T is requesting SWBT prepare a proposal for the Dallas traffic."⁵ Clearly AT&T, and likely all other purchasers of LEC access services (i.e., MCI, Sprint, and other IXCs), recognizes that alternative suppliers offering access services similar, if not identical, to SWBT services at prices which are substantially lower

³ See, for example, Charles R. Plott, "An Updated Review of Industrial Organization: Applications of Experimental Methods," in Handbook of Industrial Organization, Richard Schmalensee and Robert D. Willig, eds., vol. 2 (Elsevier Science Publishers B. V., 1989), pp. 1121-1142.

⁴ This result is discussed in Edwin Mansfield, Applied Microeconomics (W. W. Norton & Company, Inc., 1994), pp. 310-311.

⁵ Southwestern Bell Telephone, "Description and Justification," Attachment 3, Transmittal 2633, filed May 1, 1977 and RFP Tariff Rejection Order at ¶ 10.

than SWBT's are present in the relevant geographic market. Thus, one of the parties opposing SWBT's Transmittal 2633, AT&T, documents that the first prong of the competitive necessity doctrine is satisfied; lower priced alternatives to SWBT's access services exist in the relevant market.

Further, referring to the second prong of the competitive necessity doctrine, SWBT prices responding to RFPs should not be deemed unreasonably discriminatory when compared to the competitive bidding process frequently used in other competitive circumstances. The RFP mechanism is integral to the competitive process, even in the telecommunications industry. For example, bids are solicited for building construction (particular architectural requirements are specified), trenching (specific routes are required), and switch purchases (particular capabilities are requested). Customer RFPs, precisely specifying particular LEC access services, do not involve discriminatory pricing to any greater degree than is present in what are typically perceived as competitive market situations. To the extent U.S. social policy seeks to foster competition throughout telecommunications markets, prices in response to RFPs should not be declared unreasonably discriminatory because they are determined by a bid process relied upon to produce efficient prices in many other markets (e.g., construction, trenching, switch manufacturing, etc.). Within the RFP process, SWBT's bid can be no more discriminatory than competitors' bids. If the FCC is truly concerned with fostering competition in telecommunications markets, the prices resulting from processes (e.g., RFPs) that are commonplace in competitive markets should not be deemed unreasonably discriminatory.

Finally, the third prong of the competitive necessity doctrine, that prices responding to RFPs are reasonable and contribute to efficient services for all consumers, will hold as a result of competition among alternative suppliers. Prices responding to RFPs will be as reasonable and efficient as the underlying cost structures of the respondents permit. Inefficient suppliers will lose contract proposals to efficient firms, whose bid prices will be lower than their inefficient rivals'. Prices reflecting the costs of the most efficient supplier must be deemed reasonable. In addition, the FCC can rely on the profit motive to ensure that firms soliciting bids (i.e., IXC's) will efficiently specify both the input requirements and retail service characteristics.

In complying with the requirements of the competitive necessity doctrine, SWBT's Transmittal 2633 would contribute to, rather than harm, the competitive process. To the extent the FCC intends to foster vigorous competition in telecommunications markets, its decision to bar SWBT from competing by denying the applicability of the competitive necessity doctrine to Transmittal 2633 merits reconsideration.

The Commission's decision to nevertheless prohibit SWBT and other ILECs from responding to customers' RFPs effectively protects alternative suppliers from vigorous price competition and denies consumers the benefits arising from IXC's obtaining efficiently priced inputs (i.e., access services). There is nothing inherently anticompetitive in the RFP process, a mechanism routinely used to secure competitive prices for services provided to households, businesses, and government entities. Since customers solicit bids from several alternative suppliers simultaneously, the RFP process encourages price competition. Thus, the Commission's view that bidding for contracts will become a vehicle for anticompetitive practices should be reconsidered.

The Commission notes that entrants must price their services to recover their investment in network facilities within a reasonable time while earning a reasonable return on that investment.⁶ This, however, is not peculiar to alternative telecommunications service suppliers. Identical criteria enter ILEC investment and pricing decisions. The Commission also argues that, because entrants lack the “significant economies of scale” which characterize ILEC network operations and ILECs might not engage in the same degree of construction activity as entrants, entrants’ incremental costs are likely to be higher than ILECs’.⁷ As a result, SWBT and other ILECs “may find it advantageous to offer lower prices to a few relatively large access customers even when such reductions might not, in the short term, contribute as much to profits as would a generally available tariffed rates.”⁸ By “aggressively competing” against entrants, the Commission contends, SWBT or another ILEC could effectively “dissuade potential entrants from entering any of its other markets.”⁹ Thus, according to this view, by acquiring a reputation as an aggressive competitor, SWBT could foreclose competitive entry in markets not currently served by alternative suppliers. To the extent that these concerns influenced the FCC’s denial of SWBT’s Transmittal No. 2633, that decision merits reconsideration.

Since public policy is expected to encourage, rather than punish, aggressive competition, there should be legitimate concern regarding SWBT’s Transmittal No. 2633 only if the FCC’s argument focuses on allegations of anticompetitive behavior, such as

⁶ RFP Rejection Order at ¶ 49.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*, at ¶ 50.

predatory pricing, as a means of excluding ILEC competitors from local exchange markets.¹⁰ Efficient entrants, however, will not be deterred by aggressive competition. If SWBT responses to RFPs yield prices above the relevant incremental costs, there is no anticompetitive attempt to foreclose the market in which a customer solicits bids and efficient entry is not discouraged.

Further, the FCC's concern regarding incumbents' attempts to forestall competitors by reducing prices below profit maximizing levels (or intentionally decreasing contribution to common costs by lowering prices) is overstated.¹¹ For example, suppose an incumbent, deriving efficiencies from economies of scale, reduces the market price sufficiently to make profitable entry uncertain. Despite declining prices, efficient entry still occurs as entrants recognize the incumbent will not maintain prices below contribution maximizing levels in the long run. Once entry occurs and rivals deploy network facilities, the incumbent realizes its rivals' productive capacity (e.g., telecommunications network facilities) cannot be driven from the market and competition is likely a permanent characteristic of the market (i.e., even if the firm initially owning the network fails, another competitor will purchase the facilities and competition continues). Since both the incumbent's ability to recover overhead costs and the entrant's ability to earn profits will be enhanced if the market price moves toward its initial level, service price increases are likely. "If potential entrants come to recognize this possibility, limit pricing ceases to be an effective deterrent, since low preentry prices cease to convey

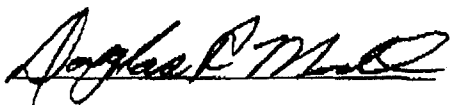
¹⁰ This is the primary point of the article cited by the Commission at ¶ 50, footnote 121. See, Janusz Ordover and Garth Saloner, "Predation, Monopolization, and Antitrust," in Handbook of Industrial Organization, Richard Schmalensee and Robert D. Willig, eds., vol. 1 (Elsevier Science Publishers B. V., 1989), pp. 550-556.

¹¹ RFP Rejection Order at ¶ 49.

a credible threat of low postentry prices."¹² If local exchange market entry occurs, or is already established, despite aggressive competition from incumbents, it is more likely that potential entrants in other segments of the incumbents' markets will persist until successful, rather than being frightened into ignoring profitable entry opportunities by an incumbent's reputation for aggressive competition. Therefore, the FCC should reconsider its argument that short-term price decreases will effectively foreclose local exchange markets to competition.

Since SWBT's Transmittal 2633 will contribute to vigorous competition in telecommunications markets and will not yield anticompetitive results (i.e., market foreclosure), the FCC's decision to preclude SWBT's participation in the competitive process by denying Transmittal 2633 should be reconsidered.

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 15, 1997.

A handwritten signature in black ink, appearing to read "Douglas R. Mudd", written in a cursive style.

Douglas R. Mudd

¹² Richard Schmalensee, "Entry Deterrence in the Ready-To-Eat Breakfast Cereal Industry," The Bell Journal of Economics, vol. 10 (Autumn 1978), p. 313.

V. CONCLUSION

For the foregoing reasons, SWBT respectfully requests that the Commission reverse its RFP Tariff Rejection Order, and allow SWBT's Transmittal No. 2633 to go into effect immediately.

Respectfully submitted,

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